

## Publications

### 2014 Pennsylvania Oil and Gas Law Review

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#### CLIENT ALERT

Over the past year, Pennsylvania has continued to lead the northeastern United States in natural gas production. According to a report published by the U.S. Energy Information Administration on November 25, 2014, Pennsylvania became the second-largest shale gas producing state in the nation in 2013, and production continued to increase throughout 2014. The Pennsylvania Department of Environmental Protection (DEP) indicates that Pennsylvania operators reported production of approximately 1.9 trillion cubic feet of natural gas from unconventional wells during the six-month period of January to July 2014. The number reflects a significant rise from the nearly 1.7 trillion cubic feet reported for the prior six-month period.

In the wake of some of the landmark decisions we saw in 2013,<sup>[1]</sup> and in spite of the continued growth of the Commonwealth's oil and gas industry, Pennsylvania had relatively few legislative, judicial and regulatory developments in 2014. New legislation relating to the industry was proposed, but few were passed and DEP regulations remained largely unchanged. The judicial arena has unquestionably seen the most development over the past year. To assist our clients and friends, we have summarized Pennsylvania's most notable legislative, judicial and regulatory developments of 2014.

#### Legislative Developments

**Lease Surrenders.** On October 22, 2014, Governor Tom Corbett signed HB 402 into law, which requires the lessee of an oil or natural gas lease to deliver to the lessor, free of cost, a recordable surrender within 30 days after the termination, expiration or cancellation of such oil or natural gas lease. If the lessee fails to provide a surrender document, the lessor may serve notice of such failure upon the lessee. The lessee may challenge the notice if the lessee believes that the oil and gas lease is in fact still in effect. Notably, the new law entitles the lessor to file in the public records an affidavit stating that the the oil and gas lease is terminated, canceled and/or expired if the lessee fails to challenge the notice or provide an appropriate surrender document.

**Production Reporting.** HB 2278, known as the Unconventional Well Report Act, was also enacted on October 22, 2014. The Unconventional Well Report Act requires operators of unconventional wells to file a monthly report specifying well-specific production amounts with the DEP. The new law indicates that the information reported will be used by the Commonwealth for enforcement, administrative and statistical purposes. The reports will also be posted for public use on the DEP's website.

**Severance Tax.** Several bills relating to a severance tax on natural gas were introduced in the Pennsylvania House of Representatives last year; however, none were enacted. In January, HB 1947 proposed a tax of 5% of the gross value of natural gas severed at the wellhead during a reporting period, plus 4.6 cents per thousand cubic foot. In August, HB 2403 was introduced which would allow Pennsylvania's unconventional gas well fee, commonly referred to as the Impact Fee, to remain in effect even if legislation imposing a severance tax was passed. HB 2508, a second bill proposing a natural gas severance tax, was introduced on September 22, 2014. The proposed tax in HB 2508 was just slightly higher than that proposed in HB 1947 at 5% of the gross value severed at the wellhead, plus 5 cents per thousand cubic foot.

**Conventional vs. Unconventional Wells.** In May of 2014, legislation which would require Pennsylvania's Environmental Quality Board to differentiate regulations relating to conventional oil and gas wells from those relating to unconventional wells was introduced as SB 1378. The bill states that small businesses involved with conventional well drilling should not be subject to the same regulations as those imposed upon drillers of unconventional wells and proposes changes which would differentiate regulations pertaining to only unconventional wells from those which pertain to both conventional and unconventional wells; however, like the severance tax bills, SB 1378 was not passed in 2014.

## Judicial Developments

**Act 13.** Act 13 of 2012, which was signed into law in February of 2012 and included extensive amendments to Pennsylvania's Oil and Gas Act (Title 58), prompted numerous constitutional challenges. The challenges to the Act related primarily to the new provisions which affected the ability of municipalities to restrict oil and gas operations through zoning regulations. In December of 2013, the Pennsylvania Supreme Court found significant portions of Act 13 of 2012 unconstitutional and remanded a number of outstanding issues to the Commonwealth Court in *Robinson Township v. Commonwealth*.<sup>[2]</sup> The Supreme Court subsequently denied an Application for Reargument and Reconsideration on February 21, 2014.<sup>[3]</sup>

On remand, the Commonwealth Court found that additional portions of Act 13 were unenforceable in an opinion issued on July 17, 2014.<sup>[4]</sup> Specifically, part of section 3302 (preempting local regulation of oil and gas operations) and sections 3305 through 3309 (granting the Pennsylvania Public Utilities Commission and the Commonwealth Court jurisdiction to review local ordinances to ensure compliance with Act 13 and withhold impact fees) were found incapable of execution as they were not severable from the unconstitutional portions of the Act. Conversely, the Commonwealth Court upheld the validity of three other challenged provisions of Act 13. The three upheld provisions (i) require notice to only public water systems following a spill resulting from drilling operations, but not private water suppliers, (ii) allow a public utility to condemn property for the injection, storage and removal of natural gas for later public use under certain circumstances and (iii) prohibit health professionals from disclosing confidential and proprietary information related to hydro fracturing chemicals.

**Seismic Testing.** On April 10, 2014, the United States District Court for the Western District of Pennsylvania issued an opinion enjoining Hempfield Township, which is located in Westmoreland County, Pennsylvania, from interfering with ION Geophysical Corporation's seismic testing operations.<sup>[5]</sup> ION had acquired all permits necessary to commence testing operations from property owners as well as state and county agencies. ION also made a good-faith attempt to negotiate a road and right-of-way use permit agreement with Hempfield Township officials, even though the township had not enacted any ordinance which required Hempfield to acquire such a road-use permit. However, after several months of discussion, Hempfield Township refused to sign a permit and informed ION that it would act to prevent ION from using Township roads for the seismic testing project.

The court for the Western District of Pennsylvania found that a township is preempted from banning seismic testing by Pennsylvania's Oil and Gas Law.<sup>[6]</sup> Notably, the court held that a township "cannot, consistent with the law, ban seismic testing by refusing to address the issue in a duly passed ordinance and by refusing to acknowledge the legitimate rights of seismic operators." Because ION had properly acquired the right to conduct seismic testing through permits from surface and mineral property owners and the appropriate governmental agencies, the court enjoined Hempfield from interfering with ION's seismic testing operations.<sup>[7]</sup>

**Location of Compressor Station.** In *MarkWest Liberty Midstream & Resources, LLC v. Cecil Township Zoning Hearing Board*, the Commonwealth Court reversed a township zoning board's denial of a special use exception application for the construction and operation of a natural gas compressor station.<sup>[8]</sup> The zoning board had denied MarkWest's application on March 31, 2011, contending that MarkWest had failed to satisfy the Unified Development Ordinance requirements of showing that the compressor station "would be of the same general character as other uses permitted" and "its impact would be equal to or less than other permitted uses." The trial court affirmed the zoning board's decision; however, on appeal, the Commonwealth Court conducted its own independent analysis under the township's Unified Development Ordinance and found that the Board's denial of the special exception application was without basis in fact or in law. The Commonwealth Court therefore remanded the matter with instructions to grant MarkWest's application.

**Title Opinions.** The Pennsylvania Superior Court recently determined that an oil and gas developer was liable for willful trespass where the developer failed to conduct a full title search prior to purchasing drilling rights under an oil and gas lease in *Sabella v. Appalachian Development Corporation*.<sup>[9]</sup> The developer chose to rely upon an existing abstract of title obtained by a predecessor in title and conducted only a "bring down" title search prior to acquiring the lease rights by assignment instead of conducting its own full title search. The "bring down" search only examined the public records for intervening events affecting title which occurred after the end date of the existing abstract of title.

Evidence produced at trial revealed that the existing abstract of title contained errors and, as a result, the developer and its predecessor had trespassed by drilling without a valid oil and gas lease. Although both good faith and bad faith trespassers are liable to the injured party for profits derived as a result of the trespass, a good faith trespasser may deduct costs incurred in generating such profits whereas a bad faith trespasser may not. The Superior Court held that the developer lost its good faith trespasser status by declining to conduct a full title search, which would have revealed that the lessor of the oil and gas lease at issue was not, in fact, the owner of all the oil and gas covered by the lease. As such, the developer was liable for all profits derived from the trespass and was not entitled to deduct any of its production costs.

**Lease Extension.** On September 29, 2014, the United States District Court for the Middle District of Pennsylvania issued an opinion in which it found that the lessee of an oil and gas lease validly extended the primary term by tendering an extension payment to the lessor's predecessor in title.<sup>[10]</sup> The oil and gas lease at issue contained an extension clause which allowed the lessee to extend the primary term of the lease by tendering an extension payment to the lessor at any time during the primary term. The lease also contained a change of ownership provision which required the lessor and/or successor lessor to notify the lessee of any change of ownership and to provide whatever documentation the lessee might reasonably require.

Well before the extension of the primary term of the lease, the lessee filed a Notice of Extension of Oil and Gas Lease in the public records and tendered the necessary extension payment to the original lessors under the lease; however, the original lessors had previously transferred their interest without providing documentation to the lessee as required under the change of ownership provision. The court found that because the lessor failed to provide documentation of the change in ownership, the lessee's payment to the original lessors validly extended the oil and gas lease under the extension clause.

**Title Washing.** In *Herder Spring Hunting Club v. Keller*, the Superior Court held that an 1899 reservation of oil, natural gas and other subsurface rights with respect to 460 acres of "unseated" lands located in Centre County, Pennsylvania was extinguished by a tax sale in 1935.<sup>[11]</sup> Until 1961, Pennsylvania tax assessment law distinguished between "unseated" lands, which were unoccupied and unimproved, and "seated" lands, which contained permanent improvements indicating a personal responsibility for taxes. In this case, the lands at issue were designated as "unseated" at the time of the 1935 tax sale. The Superior Court found that the law in effect in 1935 placed an affirmative duty upon the owners of severed oil and gas within and underlying "unseated" lands to notify the county commissioners of their subsurface interest in the event of a tax sale. The owners of the reserved oil and gas had failed to do so in this case. The Superior Court therefore concluded that the subsurface reservation was extinguished. In other words, the tax sale "washed" the title clean of the 1899 reservation and the purchaser of the land at the tax sale acquired the property, including the oil and gas, in fee simple.

**Pooling Contiguous Leases.** In *EQT Production Co. v. Opatkiewicz*,<sup>[12]</sup> EQT filed a complaint alleging that several landowner-lessors had improperly asserted that EQT was prohibited from pooling contiguous leases. The complaint referenced recently ratified Senate Bill 259, which amended the Oil and Gas Lease Act of 1979 ("OGLA") to add section 34.1. This section explicitly allows operators to pool contiguous leases using horizontal drilling unless prohibited by a lease. Prior to the enactment of OGLA, in order to pool leases to form drilling units, oil and gas operators were required to obtain modifications of existing oil and gas leases from lessors unless the lease specifically permitted unitization. In response, the lessors argued that the operative section of OGLA violated the Pennsylvania Constitution as well as the Fifth and Fourteenth Amendments and the Contract Clause of the United States Constitution.

The Common Pleas Court judge rejected the lessors arguments and ruled that EQT has the right to develop the leases jointly by horizontal drilling unless expressly prohibited by a lease. Specifically, the judge stated, "So long as the lessors' rights granted by the lease and law are not impinged upon, the lessee has broad powers to develop the oil and gas estate as it sees fit, including crossing property lines between contiguous leases while engaging in horizontal drilling."

## Regulatory Developments

**GP-5 Revisions.** On November 15, 2014, the DEP published a notice setting forth proposed revisions to the existing General Plan Approval (or General Operating Permit) commonly referred to as “GP-5,” for Natural Gas Compression and/or Processing Facilities.<sup>[13]</sup> Most notably, the amendments would delete the applicability threshold requirement for greenhouse gases in response to the United States Supreme Court’s decision in *Utility Air Regulatory Group (UARG) v. Environmental Protection Agency*,<sup>[14]</sup> broaden the scope of the GP-5 to include all types of natural gas-fired compressors and add a requirement for an annual compliance certification. Several other minor changes are also proposed to clarify certain provisions of the existing GP-5. The period for public comment on the proposed revisions ended on January 6, 2015 but the amendments to GP-5 have not yet been finalized or implemented.

**DEP Annual Report.** In May of 2014, the DEP released its first Oil and Gas Annual Report covering calendar year 2013.<sup>[15]</sup> The purpose of the Annual Report is to provide information regarding how the DEP authorizes and inspects oil and gas exploration and production operations in Pennsylvania. The Annual Report indicates that Pennsylvania produced over 3 trillion cubic feet of natural gas in the year 2013. Due to the increased production, the Annual Report states that in 2013 the DEP issued a total of 4,617 well permits, nearly two-thirds of which were permits to drill unconventional wells and performed 12,391 inspections of 5,559 unconventional wells to ensure that regulations were followed. Statistics included in the Report reveal that the number of violations cited at unconventional gas well sites steadily decreased from 2010 through 2013, but suggest that the DEP pursues enforcement actions against such violations with increasing frequency. A similar report which provides information regarding oil and gas operations in Pennsylvania during 2014 will likely be issued by the DEP in the spring of 2015.

## What We Anticipate in 2015

In light of the *Robinson Township* decisions, there is a significant void in Pennsylvania’s Oil and Gas Act (Title 58). We anticipate that new legislation and regulations will be introduced in 2015 to fill some of the gaps left by the *Robinson Township* cases and bring much-needed clarity to this very uncertain area of the law, particularly with respect to the balance between state and local regulation of oil and gas operations. As well production increases, it is likely that oil and gas lease disputes will continue to give rise to litigation. We further anticipate that some of the new legislation proposed in 2014 which was not passed, such as those bills relating to a severance tax on natural gas, may be revised and re-introduced in 2015.

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<sup>[1]</sup> In 2013, the Pennsylvania Supreme Court issued two seminal opinions in which it found significant portions of Act 13 of 2012 unconstitutional (*Robinson Twp. v. Cmmw.*, 83 A.3d 901 (Pa. 2013)) and upheld the Dunham Rule, which provides that a conveyance or reservation of “minerals” without specific reference to gas or oil gives rise to a rebuttable presumption that the parties did not intend to include natural gas or oil within the term “minerals” (*Butler v. Charles Powers Est.*, 65 A.3d 885 (Pa. 2013)).

<sup>[2]</sup> *Robinson Twp. v. Cmmw.*, 83 A.3d 901 (Pa. 2013).

<sup>[3]</sup> *Robinson Twp. v. Cmmw.*, 2014 Pa. LEXIS 513 (February 21, 2014).

[4] *Robinson Twp. v. Cmmw*, 96 A.3d 1104 (Pa. Cmmw. 2014).

[5] *ION Geophysical Corp. v. Hempfield Twp.*, 2014 U.S. Dist. LEXIS 49549 (W.D. Pa. April 10, 2014).

[6] 58 Pa.C.S. § 3302 (2012).

[7] Kevin M. Gormly and Melissa McCoy Gormly of Vorys' Pittsburgh office served as counsel for ION Geophysical Corporation in its action against Hempfield Township.

[8] *MarkWest Liberty Midstream & Res., LLC v. Cecil Twp. Zoning Hearing Bd.*, 102 A.3d 549 (Pa. Cmmw. 2014).

[9] *Sabella v. Appalachian Dev. Corp.*, 103 A.3d 83 (Pa. Super. 2014).

[10] *Danko Holdings, L.P. v. EXCO Res. (PA), LLC*, 2014 U.S. Dist. LEXIS 137104 (M.D. Pa. September 29, 2014).

[11] *Herder Spring Hunting Club v. Keller*, 93 A.3d 465 (Pa. Super. 2014).

[12] *EQT Production Co. v. Opatkiewicz*, Allegheny County Court of Common Pleas, Civil Division, No. GD-13-13489.

[13] Notices: Proposed Modifications to General Plan Approval and/or General Operating Permit No. 5 for Natural Gas Compression and/or Processing Facilities (BAQ-GPA/GP-5), 44 Pa.B 7243, Saturday, November 15, 2014, <http://www.pabulletin.com/secure/data/vol44/44-46/2370.html>

[14] *Util. Air Regulatory Group v. EPA*, 134 S. Ct. 2427 (June 23, 2014) (holding that the EPA exceeded its authority in applying greenhouse emissions regulations for large stationary sources of pollution to smaller emitters).

[15] 2013 Oil and Gas Annual Report, Pennsylvania Department of Environmental Protection, [http://www.portal.state.pa.us/portal/server.pt/community/annual\\_report/21786](http://www.portal.state.pa.us/portal/server.pt/community/annual_report/21786)